STATE OF COLORADO
PUBLIC UTILITIES COMMISSION

Annual Certification of Rural Local Exchange Carriers
By State Commission for Federal High-Cost Support

Introduction

On May 10, 2001, the Federal Communications Commission (FCC) adopted the Fourteenth Report and Order, Twenty-Second Order on reconsideration, and further notice of proposed rulemaking in CC Docket No. 96-45, and Report and Order in CC Docket No. 00-256. In this Order, with the recommendation of the Federal-State Joint Board on Universal Service, the rules for providing high-cost universal service support to rural telephone companies were modified. The new rules were designed to strike a fair and reasonable balance among the universal service principles and goals enumerated in Section 254 of the Communications Act of 1996. The goal of the FCC and the Joint Board was to provide predictable levels of support so that rural carriers can continue to provide affordable service in rural America, while ensuring that consumers in all areas of the nation, including rural areas, have access to affordable and quality telecommunication services.

As amended, § 47 C.F.R. 54.314 (a) states:

> State certification. States that desire rural incumbent local exchange carriers . . . to receive support pursuant to §§ 54.301, 54.305, and/or 54.307 and/or part 36, subpart F of this chapter must file an annual certification with the Administrator and the Commission stating that all federal high-cost support provided to such carriers within that State will be used only for the provision, maintenance, and upgrading of facilities and services for which the support is intended....[1]

Annual certifications shall be filed with the FCC and the Universal Service Administrative Company (USAC) by October 1 of each year.

Initial Screening: 2004 Financial and Operational Evaluation Criteria

Staff conducted an initial screening of all rural carriers that receive federal USF support using financial and operational data from the annual reports filed with the Commission by each Local Exchange Carrier (LEC). Specifically, Staff examined four criteria as explained below.

First, Staff compared the dollar amount of plant additions for the past three years against the depreciation expense and the federal USF support received over that same time period. The comparison does not consider maintenance expenses, which are another approved use of federal USF support, because some rural LECs do not have separate accounting codes for maintenance expenses. Staff used the following formula to evaluate whether federal USF

[1] Services targeted for federal universal support are defined at 47 CFR 54.101(a). In Colorado, the primary service impacted is basic local exchange service.

support is being spent for the intended purpose:

$$\frac{\text{Total Plant Additions}}{(\text{Federal USF Support} + 30\% \text{ of Depreciation Expense})^{2}}$$

Staff's 2004 comparison is attached to this report as Appendix A. Plant additions include outside plant (e.g., buried and aerial cable, poles, etc.), central office equipment (e.g., digital switching, circuit equipment), and Construction Work in Progress (CWIP).

There is typically an 18-month lag from the time when the rural LEC makes capital expenditures or pays maintenance expenses and the time it recovers that investment through federal USF support. Consequently, it is more meaningful to look at three years of data because this smoothes out the lag time and accounts for any fluctuations in the national average loop cost (NALC). The NALC is the average cost per loop above which a company is eligible to receive federal USF support. The LEC can also file revisions of the NECA form if there are material changes that would impact the average support received in a given quarter.

Second, Staff attempted to verify that the federal USF support reported on the rural ILEC's 2003 annual report to the PUC was consistent with the amount paid according to the Universal Service Administrative Company (USAC), which is a non-profit organization whose purpose is to administer payments of federal USF support as calculated by the National Exchange Carriers Association (NECA). This was accomplished by gathering information from the USAC web site. Unfortunately, USAC reports estimated rather than actual payments. However, Staff was able to verify that the estimated payments were very similar to the amounts reported on each rural ILEC's annual report to the PUC. USAC estimated payment information is shown in Column N of Appendix A.

Third, Staff reviewed service quality statistics such as the number of held orders at year end (as reported on a company's annual report to the PUC) and the number of customer complaints (as reported by External Affairs). Staff believes that service quality is an important qualitative measure of whether the rural LEC has made adequate investments in previous years. While poor service quality alone would not be sufficient grounds to withhold federal USF support, it would be cause for Staff to further investigate the rural LEC's investments and capital budgets. This service quality information is attached to the report as Appendix B. Without exception, the service quality among rural ILECs appears to be very good as measured by both held orders and customer complaints.

Affidavit Requirement

Fourth, Each rural LEC operating in Colorado was required to file an affidavit signed by an officer, director, partner, owner, or authorized employee, attesting to the fact that they will use federal high-cost support for the provision, maintenance, and upgrading of facilities and services for which the support is intended. The affidavit also stated that the company attests to the fact

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[2] While 30% of depreciation expense is not a precise figure for each and every rural ILEC, it was recommended by senior engineering staff as an appropriate percentage to include in the divisor to account for depreciation.

that financial information reported on the annual reports submitted to the Colorado PUC is true, accurate and correct to the best of their knowledge. All rural LECs have filed an affidavit.

Results of Initial Screening

Using the above criteria, Staff categorized the thirty-one rural ILECs into five groups, as follows:

Group One: Companies that were Audited in Past Year or in the Current Year

Companies in Group one were sent audit letters in 2003 or are being audited in 2004. Rico and Farmers were audited beginning in May of 2004, and Staff is still in the process of finishing the final audit report. Staff is confident that federal USF support is being used to support basic local exchange service. Haxtun, Peetz, and Stoneham were sent audit letters and provided the Commission staff with additional information in 2003.

1. Rico Telephone Company
2. Farmers Telephone Company
3. Haxtun Telephone Company
4. Peetz Cooperative Telephone Company
5. Stoneham Telephone Company

Group Two: Companies with a Recent Rate Case

Companies in Group Two had a recent current rate case before the Commission. Staff addressed the federal USF issues as part of those rate cases, so additional information was not required from the companies in Group Two. Staff recommends certification of the following companies in Group Two:

1. Phillips County Telephone Company
2. Pine Drive Telephone Company
3. Roggen Telephone Company

Group Three: Companies that Conduct a Majority of Business in Adjacent States

Companies in Group Three conduct a majority of their business in adjacent states, and Staff recommends that, as in 2003, the Commission rely on a copy of their certification letter from the adjacent state as evidence of their compliance with the USF requirements. Staff recommends certification for the following companies in Group Three:

1. Dubois Telephone Exchange
2. Great Plains Telephone Company
3. Union Telephone Company
4. S&T Telephone Company

Group Four: Companies that Passed Initial Screening

Staff has concluded that the most important indicator is whether a company is spending federal USF dollars to upgrade and maintain facilities for the provisioning of basic local exchange service. Based on the results of Staff's initial screening process, the companies in Group Four appear to meet this standard. Therefore, Staff recommends certification of the following companies in Group Four:

1. Agate Telephone Company
2. Blanca Telephone Company
3. CenturyTel of Eagle
4. CenturyTel of Colorado
5. Eastern Slope Rural Telephone Association
6. El Paso County Telephone
7. Nucla-Naturita Telephone Company
8. Nunn Telephone Company
9. Rye Telephone Company
10. South Park Telephone Company
11. Strasburg Telephone Company
12. Wiggins Telephone Association
13. Willard Telephone Company

<u>Group Five: Companies that Did Not Pass Initial Screening</u>

The following companies in Group Five did not pass Staff's initial screening.

1. Big Sandy Telephone
2. Bijou Telephone Cooperative Association
3. Delta County Tele-Com, Inc.
4. Columbine Telephone Company
5. Plains Cooperative Telephone Company
6. Sunflower Telephone Company

Therefore, Staff requested additional information from all six of the Companies listed above in order to determine whether they appear to be spending federal USF support for the intended purpose. The specific results of those inquiries are presented later in this report.

Additional Review of Companies that Did Not Pass Initial Screening

On August 18, 2004, Staff sent letters to all six companies listed above requesting additional information such as capital expenditure budgets for 2004 or 2005, network maintenance expenses, a copy of the two page filing made with NECA on July 1, 2004 which is used to calculate USF support, and the company's trial balance for the prior year.

Reports on Individual Companies Not Passing Initial Screening

The following section summarizes the results of Staff's initial screening of Haxtun and Peetz, the additional information provided by the companies, and Staff's comments and recommendations for these two companies.

Bijou Telephone Cooperative Association, Inc.

Initial Screening Results

- ✓ Plant Additions for 2001 through 2003 were 57% of Total USF Support plus 30% of Depreciation Expense for the same time period.
- ✓ Rate of Return on rate base for 2003 was 13.29%.
- ✓ Company did not pay dividends in 2003.
- ✓ No customer complaints in 12 months ending June 30, 2004, and 3 held orders as of December 31, 2003.
- ✓ No out-of-period adjustments that would lower reported revenues or rates of return.
- ✓ Company's telephone plant is 48.73% depreciated as of 2003.

Additional Information Provided on September 15, 2004

- ✓ Bijou's 2005 capital budget indicates that the company plans to spend $300,000 on Central Office and Circuit Equipment, $200,000 on Digital electronic switching, and $75,000 on Circuit Equipment.
- ✓ Bijou spent $715,490 on network maintenance expenses during 2003.
- ✓ Bijou provided a copy of its trial balance for 2003.

Staff Comments

- ✓ Staff verified that the information provided on the 2003 trial balance ties to the PUC annual report. Assuming that this same information was used to prepare the July 21, 2004 NECA filing, Staff is comfortable that Bijou is reporting the correct investments and expenses on the filing on which USF support is based.

- ✓ Network maintenance expense is an allowable expense for purposes of federal USF support. The information provided by Bijou suggests that the company is using federal USF support to upgrade and maintain its network infrastructure.
- ✓ Bijou spent over $1.4 million on network maintenance expense and plant additions in 2001 to 2003 compared to $1.5 million in federal high cost loop support and depreciation expense.
- ✓ Based on the additional information provided, Staff recommends that the Commission certify Bijou Telephone Cooperative Association, Inc. to continue receiving federal USF support in 2005.

Big Sandy Telecom, Inc.

Initial Screening Results

- ✓ Total Plant Additions for 2001 through 2003 were 79% of Total USF Support plus 30% of Depreciation Expense for the same time period.
- ✓ Central Office Equipment per Access Line declined from 2001 to 2003.
- ✓ Rate of Return on rate base for 2003 was 13.15%
- ✓ No customer complaints in 12 months ending June 30, 2004, and no held orders as of December 31, 2003.
- ✓ Company's telephone plant is 71.35% depreciated as of 2003.

Additional Information Provided on September 17, 2004

- ✓ Big Sandy provided a capital budget and actual expenditure report for 2004.
- ✓ Big Sandy spent $479,268 on network maintenance expenses during 2003.
- ✓ Big Sandy provided a copy of its 2-page federal USF filing made with NECA on July 1, 2004.
- ✓ Big Sandy provided a copy of its trial balance for 2003.

Staff Comments

- ✓ Staff verified that the information provided on the NECA filing ties to the 2003 trial balance and the PUC annual report. Staff is comfortable that Big Sandy is reporting the correct investments and expenses on the filing on which USF support is based.

- ✓ Network maintenance expense is an allowable expense for purposes of federal USF support. It is not captured on the PUC's annual report because some rural ILECs do not account separately for it. Big Sandy included some accounts in network maintenance expense that were not allowed. Staff has deducted those amounts from the network maintenance expense. The remaining amount of network maintenance expense suggests that Big Sandy is using federal USF support to upgrade and maintain its network infrastructure.

- ✓ Big Sandy spent over $1.3 million on network maintenance expense and plant additions in 2001 to 2003 compared to $896,599 in federal high cost loop support and depreciation expense.

- ✓ Based on the additional information provided, Staff recommends that the Commission certify Big Sandy Telecom, Inc. to continue receiving federal USF support in 2005.

Columbine Telecom Company

Initial Screening Results

- ✓ Total Plant Additions for 2001 through 2003 were 80% of Total USF Support plus 30% of Depreciation Expense for the same time period.

- ✓ Rate of Return on rate base for 2003 was 15.25%

- ✓ Columbine paid dividends in 2003 of $379,000.

- ✓ Columbine had 1 customer complaint in 12 months ending June 30, 2004, and no held orders as of December 31, 2003.

- ✓ Company's telephone plant is 49.77% depreciated as of 2003.

Additional Information Provided on September 17, 2004

- ✓ A capital budget and actual expenditure report for 2004.

- ✓ Columbine spent $417,662 on network maintenance expenses during 2003.

- ✓ Columbine provided a copy of its 2-page federal USF filing made with NECA on July 1, 2004.

- ✓ Columbine provided a copy of its trial balance for 2003.

Staff Comments

- ✓ Staff verified that the information provided on the NECA filing ties to the 2003 trial balance and the PUC annual report. Staff is comfortable that Columbine is reporting the correct investments and expenses on the filing on which USF support is based.

- ✓ Network maintenance expense is an allowable expense for purposes of federal USF support. Columbine captured three accounts that were not allowed in the calculation of network maintenance. Staff has calculated the appropriate amount for network maintenance and had determined by the information provided, that the company is using federal USF support to upgrade and maintain its network infrastructure.

- ✓ Columbine spent over $2.4 million on network maintenance expense and plant additions in 2001 to 2003 compared to approximately $2.1 million in federal high cost loop support and depreciation expense.

- ✓ Based on the additional information provided, Staff recommends that the Commission certify Columbine Telecom Company to continue receiving federal USF support in 2005.

Delta County Telephone Company

Initial Screening Results

- ✓ Total Plant Additions for 2001 through 2003 were 89% of Total USF Support plus 30% of Depreciation Expense for the same time period.

- ✓ Rate of Return on rate base for 2003 was 7.87%

- ✓ Delta did not pay a dividend in 2003.

- ✓ No complaints in 12 months ending June 30, 2004, and no held orders as of December 31, 2003.

- ✓ Company's telephone plant is 50.88% depreciated as of 2003.

Additional Information Provided on September 17, 2004

- ✓ Delta provided the capital budget for 2004.

- ✓ Delta spent $945,915 on network maintenance expenses during 2003.

- ✓ Delta provided a copy of its 2-page federal USF filing made with NECA on July 1, 2004.

- ✓ Delta provided a copy of its trial balance for 2003.

Staff Comments

- ✓ Staff verified that the information provided on the NECA filing ties to the 2003 trial balance and the PUC annual report. Staff is comfortable that Columbine is reporting the correct investments and expenses on the filing on which USF support is based.
- ✓ Network maintenance expense is an allowable expense for purposes of federal USF support. The information provided by Delta satisfies Staff and suggests that the company is using federal USF support to upgrade and maintain its network infrastructure.
- ✓ Delta spent over $4.6 million on network maintenance expense and plant additions in 2001 to 2003 compared to $2.9 million in federal high cost loop support and depreciation expense.
- ✓ Based on the additional information provided, Staff recommends that the Commission certify Delta County Telephone Company to continue receiving federal USF support in 2005.

Plains Cooperative Telephone Association

Initial Screening Results

- ✓ Total Plant Additions for 2001 through 2003 were 69% of Total USF Support plus 30% of Depreciation Expense for the same time period.
- ✓ Rate of Return on rate base for 2003 was 12.03%
- ✓ Company did not pay a dividend.
- ✓ No customer complaints in 12 months ending June 30, 2004, and no held orders as of December 31, 2003.
- ✓ Company's telephone plant is 61.13% depreciated as of 2003.

Additional Information Provided on September 17, 2004

- ✓ Plains capital budget for local exchange service for 2004.
- ✓ Plains spent $623,050 on network maintenance expenses during 2003.
- ✓ Plains provided a copy of its 2-page federal USF filing made with NECA on July 1, 2004.

- ✓ Plains provided a copy of its trial balance for 2004.

Staff Comments

- ✓ Staff verified that the information provided on the NECA filing ties to the 2003 trial balance and the PUC annual report. Staff is comfortable that Plains is reporting the correct investments and expenses on the filing on which USF support is based.

- ✓ Network maintenance expense is an allowable expense for purposes of federal USF support. The information provided by Plains suggests that the company is using federal USF support to upgrade and maintain its network infrastructure.

- ✓ Plains spent over $2.5 million on network maintenance expense and plant additions in 2001 to 2003 compared to $2.2 million in federal high cost loop support and depreciation expense.

- ✓ Based on the additional information provided, Staff recommends that the Commission certify Plains Cooperative Telephone Association to continue receiving federal USF support in 2005.

Sunflower Telephone Company

Initial Screening Results

- ✓ Total Plant Additions for 2001 through 2003 were 28% of Total USF Support plus 30% of Depreciation Expense for the same time period.

- ✓ Outside Plant per access line decreased significantly from 2001 to 2003 ($174,643 vs. $21,193).

- ✓ Company did not pay a dividend.

- ✓ No customer complaints in 12 months ending June 30, 2004, and no held orders as of December 31, 2003.

- ✓ Company’s telephone plant is 75.22% depreciated as of 2003.

Additional Information Provided on September 17, 2004

- ✓ Sunflower provided the 2004 Capital budget.

- ✓ Sunflower spent $54,616 on network maintenance expenses during 2003.

- ✓ Sunflower provided a copy of its 2-page federal USF filing made with NECA on July 1, 2004.

- ✓ Sunflower provided a copy of its trial balance for 2003.

Staff Comments

- ✓ Staff verified that the information provided on the NECA filing ties to the 2003 trial balance and the PUC annual report. Staff is comfortable that Sunflower is reporting the correct investments and expenses on the filing on which USF support is based.

- ✓ Network maintenance expense is an allowable expense for purposes of federal USF support. It is not captured on the PUC's annual report because some rural ILECs do not account separately for it. Sunflower included amounts not allowed in network maintenance expense such as Land and Building, and Office Equipment, the amounts were not included in Staff's calculation. The remaining amount in network maintenance expense indicates that Sunflower is using federal USF support to upgrade and maintain its network infrastructure.

- ✓ Based on the additional information provided, Staff recommends that the Commission certify Columbine Telephone Company to continue receiving federal USF support in 2004.

Requirement to Certify Eligible Telecommunications Carriers

Rule 54.314 also requires state commissions to certify competitive eligible telecommunications carriers (ETCs) that receive federal USF support. In Colorado, San Isabel Telecom, Inc. was designated an ETC on January 10, 2003, but the company has not yet begun to receive USF support. According to USAC, the Commission must first certify that San Isabel Telecom will use federal USF support for the intended purpose before it is eligible to start receiving funding.

San Isabel provided a capital budget for 2004 and 2005. San Isabel is spending a majority of capital expenditures on the expansion of its wireline and wireless network and capabilities.

Like the ILECs, San Isabel provided an affidavit attesting to the fact that the company will use the federal USF support "only for the provision, maintenance and upgrading of facilities and services for which the support is intended".

Based on the information provided by San Isabel, Staff recommends that the Commission certify San Isabel Telecom to receive federal USF support in 2005.

Decision to Certify Wireless Eligible Telecommunications Carriers

Two wireless carriers have been designated as ETCs in Colorado: Western Wireless (WWC) and Northeast Colorado Cellular (NECC). Both companies currently receive federal USF support for rural lines in the State of Colorado. The Commission has determined that it should assert jurisdiction over the certification of wireless ETCs to the FCC and USAC.

Northeast Colorado Cellular

Specifically, NECC provided Staff with federal USF support received in 2004 and year to date 2005; total capital expenditures in Colorado for 2003; total depreciation expense in Colorado for 2003; network maintenance costs in Colorado for 2003; a capital expenditures budget amount for 2004. Based on this information, it appears that NECC is spending much more on plant investments and network maintenance expense than it has received in federal USF support. Therefore, Staff recommends that the Commission certify Northeast Colorado Cellular to receive federal USF support in 2005. Staff will continue to work with NECC in the coming months to ensure that the capital expenditures reported by the company are directly related to the provision, maintenance and upgrading of services and facilities for which the support is intended.

Western Wireless

WWC provided Staff with federal USF support received in 2003 and estimated receipts for 2004; total plant additions to support basic service in Colorado for 2001 and 2002; 2003 expenditures for provision, maintenance, and upgrading of facilities and services; year to date 2004 expenditures for provision, maintenance, and upgrading of facilities and services through July 31, 2004; and an affidavit attesting to use of federal high cost support for the intended purpose. Based on this information, it appears that WWC is spending much more on plant investments and network maintenance expense than it has received in federal USF support. Therefore, Staff recommends that the Commission certify Western Wireless to receive federal USF support in 2005.

Summary of Recommendations

Staff recommends that the Commission certify all 31 rural local exchange carriers, eligible telecommunications carriers serving in the service area of a rural local exchange carrier (San Isabel Telecom), and both wireless eligible telecommunications carriers (NECC and WWC) Colorado to receive federal USF support in 2005. At the direction of the Commission, Staff will mail the certification letter, signed by the Director of the Colorado PUC, to the Secretary of the FCC and the Administrator of USAC before October 1, 2004. A copy of the certification letter and this report will also be sent to each affected carrier.